

Runaway Markets

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Retail trading

Reddit traders wage battle against Wall Street

Investors and former regulators are growing concerned over rising impact on broader market



Shares in GameStop, a struggling New York-listed games retailer, were sent flying last week by gangs of amateur traders co-ordinating moves on Reddit message boards © FT montage; Bloomberg

Eric Platt and Colby Smith in New York 5 HOURS AGO

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This new legion of day traders, equipped with free trading platforms, spare cash, and boredom, has set its sights on a growing list of US-listed companies over the past several weeks.

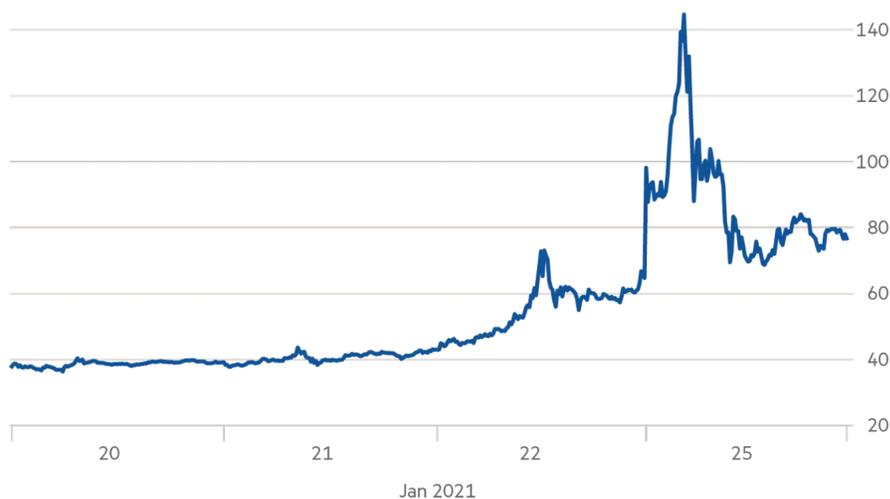
GameStop, a games retailer whose shares have been sent flying by gangs of traders co-ordinating moves on Reddit, sits at ground zero of a battle that has shown these have-a-go investors are no longer just a sideshow.

The impact is now spreading to other stocks and tripping up sophisticated hedge funds that take pride in their superior skills at navigating markets. Alarm bells are ringing among investors and former Wall Street regulators who see worrying parallels to the pump-and-dump schemes that proliferated in the dotcom era.

“The people who get hurt on these things . . . are the people who buy at pumped-up prices thinking they’re on a rocket ship ride upward and in fact that rocket ship is going to crash,” said Steve Cutler, a partner at Simpson Thacher and former enforcement chief of the Securities and Exchange Commission.

Retail investors power GameStop frenzy

Share price (\$)



Source: Bloomberg
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Years before Reddit's founding, day traders swapped stock tips on sites like RagingBull.com and Silicon Investor. One online tipster, known as Tokyo Joe, became so popular he started a website, drawing thousands of paying subscribers. He ultimately drew the scrutiny of securities regulators in the dotcom boom, and agreed to pay \$755,000 to settle [a regulatory suit](#).

Market watchers see similarities to that era now. Shares in GameStop surged 145 per cent to their peak on Monday, after a dizzying rally on Friday, as users on Reddit declared the company and another suddenly loved stock — BlackBerry — were going “to the fucking moon”.

Runaway Markets



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In the frenzied GameStop trading, Redditors had a clear goal in addition to simply jacking up their favoured bet: they wanted to [flush out two hedge funds](#) that were running negative bets on the stock.

Their persistence prompted a rescue package for one of those funds [on Monday](#), as Citadel and Point72 Asset Management agreed to pump \$2.75bn into Melvin Capital — a fund targeted on Reddit [for several months](#). The founder of the other — noted short seller Andrew Left of Citron Research — last week backed away from any further comment on GameStop, saying his views had drawn online abuse by a “mob”.

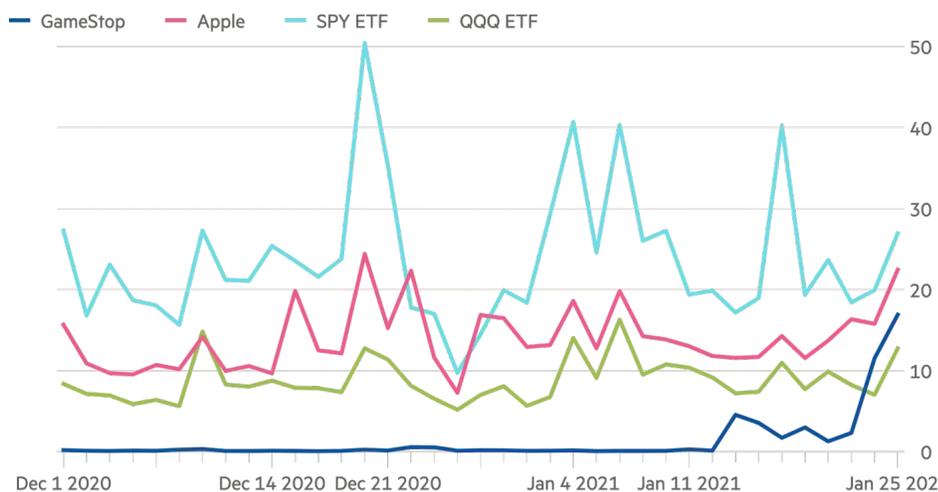
“These are not idiosyncratic events,” said Andrew Slimmon, portfolio manager at Morgan Stanley Investment Management. “It is a reflection of the fact that you have a growing cohort of people moving the market. I would be very careful shorting [certain] companies because the liquidity is there and flowing.”

Analysts note that Americans are likely to receive \$1,400 government stimulus cheques in March, some of which could find its way into stocks.

The coarsely jocular Reddit postings, many from users whose names are too impolite to print, are likely to draw the attention of regulators in Washington even if the cases prove difficult to bring, former Securities and Exchange Commission enforcement officials said.

GameStop: one of the biggest trades on Monday

Value of shares traded each day (\$bn)



Source: Bloomberg
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John Stark, a lecturer at Duke Law who previously led the SEC's Office of Internet Enforcement, said the commission staff would probably investigate whether Reddit users were making false or misleading statements to woo other investors into a stock.

"There's a whole group of investors who really don't care about the inherent value of a company," he said. "They just care if there's someone else who will pay a higher price."

The SEC is also likely to investigate whether users are being paid for their recommendations by companies or other organisations seeking to move a stock. Any investigation could take months — or longer — involving subpoenas of user IP addresses and broker trading records, Mr Cutler said.

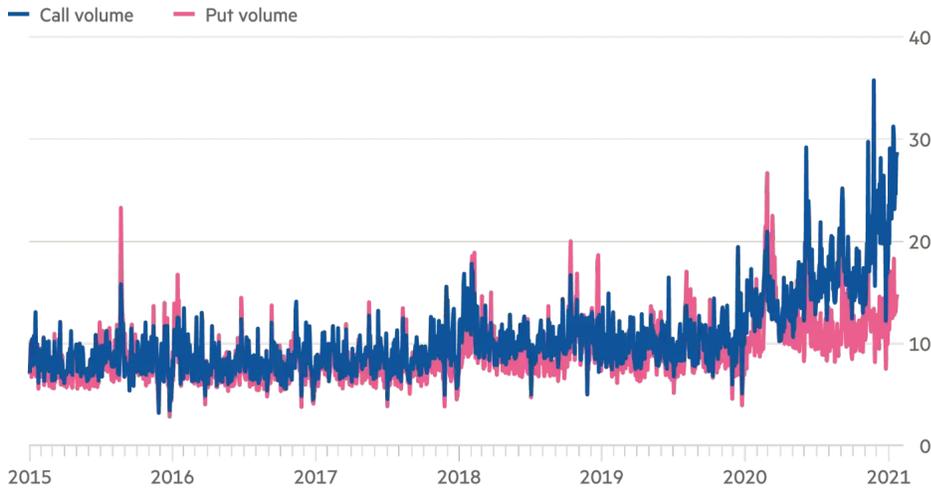
The commission can also intervene sooner if it sees egregious market moves or suspects manipulation by suspending trading in a stock or by seeking temporary relief through the courts. Mr Cutler noted, though, that suspensions were often unpopular because it left investors who had jumped into the stock stuck in the shares.

The SEC declined to comment. Reddit said it prohibited the facilitation of "illegal transactions" and that it would "review and co-operate with valid law enforcement investigations or actions as needed".

Options are central to retail investors' success in moving markets, with the use of the instruments that let traders bet on the direction of stock prices being amplified by no-commission websites such as Robinhood. In aggregate, this has forced big brokers to buy stocks to hedge their own risks, helping supercharge the influence of day traders who typically have much less financial firepower than their established Wall Street rivals.

The retail day-trader's favoured way to bet: options contracts

Number of options contracts purchased each day (m)



Source: Bloomberg
© FT

Chris Murphy, co-head of derivatives strategy at Susquehanna International Group, said rising prices of other heavily-shorted stocks showed that this activity was spreading around the US stock market. The 50 stocks most frequently shorted by hedge funds have outperformed the S&P 500 so far this year, according to Goldman Sachs.

“If you’re an institution and you’re short some stocks, you may look at the GameStop situation and think it is not worth the risk, and cover your position,” Mr Murphy said. “And then you have shorts being covered everywhere.”

Analysts across Wall Street updated institutional clients including pension funds and hedge funds on Monday with lists of stocks they believed could face the same storm as GameStop and BlackBerry.

“You used to have a world where everyone was watching [CNBC presenter] Jim Cramer on TV and he would talk about something and [the stock] would go crazy,” said a trader at a large broker in New York, who requested anonymity. “You are now in a world where it is coming from a lot of social media platforms. In many ways, it is a lot more democratized . . . [but] it is more difficult to understand how much of it is real.”

Additional reporting by Patrick Temple-West and Robin Wigglesworth

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